

# CAMBERVIEW

PARTNERS

## The Passive Revolution:

### Key Observations Regarding the WSJ's "Passivist" Series

Passive investors' governance teams have been steadily increasing in power and importance within the shareholder landscape. Today, the top governance-focused investors<sup>1</sup> each manage at least \$500 billion in assets. Together, they control 30% of the outstanding shares of S&P 500 firms and account for 41% of the outstanding institutional investor ownership at those companies, up from 19% and 23% in 2005, respectively. This fundamental change in our economy is now being acknowledged and deeply analyzed by a growing body of commentators – of which the Wall Street Journal's recent "[The Passivists](#)" series is a prominent example.

Many factors have contributed to this rise in influence, including the consolidation of assets at the largest passive funds and the passage of Dodd-Frank with its introduction of mandatory Say-on-Pay votes. Not the least of these factors has been the increasing importance passive funds place on exercising their voting power, fueled in part by the Sarbanes-Oxley Act's vote disclosure requirement. Indeed, John Bogle, founder of the Vanguard Group, acknowledges that, "we moved from a position of reluctance to make our weight felt to absolute interest in making our weight felt."

Key takeaways and highlights from the Wall Street Journal series include:

- **Evidence supporting the rise of the passive manager is robust.** The assets managed by the Vanguard 500 Index Fund's assets (\$469 billion) are nearly as much as the sum of the assets managed by the four largest active funds, while over the last 10 years, between 71%-93% of U.S. stock mutual funds either closed or failed to beat their closest index funds
- **Although the passive funds are not afraid to vote against management, they generally view engagement with management to be more effective.** Michelle Edkins, Global Head of BlackRock's Investment Stewardship team, noted that BlackRock typically gives companies a year to show an effective response to BlackRock's feedback before voting against management
- **Even while the passive funds demand engagement with their portfolio companies, they are constrained by the sheer size of their holdings and the capacity of their teams.** BlackRock's governance team of approximately two dozen oversees voting at over 14,000 public companies; Vanguard's team of about 15 oversees 13,000 public companies globally; and Rakhi Kumar, Head of Corporate Governance at State Street Global Advisors, "tells her team not to agree to every meeting companies ask for because of time constraints"
- **Corporate governance remains a key tool for passive investors to ensure long-term performance.** Vanguard's Fund Treasurer and Head of Corporate Governance, Glenn Booraem emphasizes this point by saying, "We're riding in a car we can't get out of...Governance is the seat belt and air bag"
- **Asset owners are moving their assets away from active management and into passive funds.** In 2015, 60% of public pension funds' stock allocations were devoted to index funds, up from 38% in 2012

---

<sup>1</sup> Institutional investors as defined by CamberView's proprietary analysis: BlackRock, Vanguard, State Street Global Advisors, Fidelity, JP Morgan, Bank of New York Mellon, Capital Research, Northern Trust, Wellington, Franklin Resources, TIAA, Invesco, T. Rowe Price

# CAMBERVIEW

PARTNERS

- **The definition of “active” management is changing.** Dimensional Fund Advisors’ focus on targeting the timing of purchasing assets and small-cap stocks has made it the fastest-growing major mutual fund in the U.S. and fueled its rise to the sixth largest mutual fund manager. Next-generation index funds are coming to the forefront, including fundamental or smart-beta indexes that rebalance on the basis of a company’s attributes
- **Active managers are increasingly participating in the passive investing trend.** Fidelity Investments, historically known as an active manager, currently has 12% of its assets under management dedicated to index strategies – twice the level of five years ago
- **Even one of the world’s most renowned active managers – Warren Buffet – acknowledges the benefits of passive management.** Buffet has reportedly urged the executors of his will to place 90% of his estate in “a very low-cost S&P 500 index fund”

**Thoughtful Engagement with Passive Investors is Critical.** As passive managers continue to increase their ownership stake in U.S. companies, corporate boards and executives must be prepared to understand how passive investors’ perspectives on business strategy, governance, compensation and risk oversight differ from their actively managed counterparts. Additionally, as investor teams begin to limit companies’ access to their governance teams in light of the growing demand for engagement, it remains critical for issuers facing controversial voting items to ensure open dialogue with the investor voting teams. This will require adopting and mastering a new style of investor engagement – one that is attuned to the unique characteristics of engagement demanded by these governance teams.

## About CamberView

*CamberView Partners is the leading provider of independent, investor-led advice to public companies on how to successfully manage investor engagement, contested situations and complex and challenging corporate governance issues. We advise company executives and boards on a wide range of events including contested merger situations, hedge fund activism, director elections, compensation matters, difficult shareholder proposals, sustainability and more. CamberView helps its clients succeed with their investors by providing insight into the investor’s perspective, explaining how investors will respond to the company’s proposals, and creating successful proactive strategies for investor engagement.*

## CamberView Team

### **Abe Friedman**

415.906.6501

[abe.friedman@camberview.com](mailto:abe.friedman@camberview.com)

### **Chris Wightman**

415.906.6504

[chris.wightman@camberview.com](mailto:chris.wightman@camberview.com)

### **Juan Bonafacino**

415.906.6523

[juan.bonifacino@camberview.com](mailto:juan.bonifacino@camberview.com)

### **Lauren Gojkovich**

212.235.2916

[lauren.gojkovich@camberview.com](mailto:lauren.gojkovich@camberview.com)